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Uruguay Round Enters New Phase

Multilateral trade negotiations are at a stage where the harvest will have to be collected soon. But many are hoping that new proposals -- some not yet submitted -- still will have time to blossom into agreements. However, some consider the recent response from the European Community to a U.S. farm proposal suggestive of a wintry blast. These ongoing negotiations under the General Agreement on Tariffs and Trade began in 1986 and are scheduled for completion in December 1990. Dubbed the Uruguay Round, they have been described as the most ambitious of the rounds held periodically since World War II, but during the past three years they sometimes have appeared to be on the verge of collapse. (For an overview of the Uruguay Round and previous rounds, see JEI Report No. 25A, June 30, 1989).

In late October Washington presented its plans on agriculture and services, two of the 15 sectors under discussion, to the respective GATT negotiating groups then reconvening in Geneva. Most of the attention centered on agriculture, the sector that had been responsible for much of the tumult in review sessions last December in Montreal and again this April in Geneva (see JEI

higher than its overall industrial country-average forecast of 3.5 percent. The IMF expects Japan's current account imbalance to creep downward to $72 billion in 1989 from $79.6 billion in 1988. The news will worsen in 1990, however. Although the IMF projects that real Japanese growth will reach 4 percent, exceeding the industrial-country average of 2.9 percent, the world monetary body also expects Japan's current account imbalance to widen to $90 billion, reflecting, in part, the weakness of the yen through much of 1989.

The IMF's proposed tonic for the 1990s is an alternative that many Americans have tired of hearing: cutting the U.S. budget deficit. Among its various scenarios ranging from no response -- and an eventual loss of nerve among foreign investors in the U.S. economy -- to a cut in the U.S. red ink in line with budget-reduction targets under the Gramm-Rudman-Hollings act, the IMF finds that the latter course would have several important effects. These include somewhat slower growth for Japan and other American trading partners and commensurate benefits in terms of the value of the dollar and interest rates, a particular concern for heavily indebted developing countries. Both Japan and West Germany would experience significant and lasting reductions in their current account surpluses.

If the IMF report sketches possible pitfalls during the next year or so and how to avoid them, the GATT study lays out what could be. It points out that world trade is growing twice as fast as output, with growth concentrated in manufactured goods and, within that sector, capital goods. Both the United States and Japan experienced a rapid expansion in imports of capital goods during 1988. In Japan capital goods imports grew twice as fast as business investment, which itself expanded at a fast pace. In the United States capital goods accounted for half of export growth and almost two-thirds of import growth between 1986 and 1988.

Capital goods are one of the basic building blocks of higher productivity. Their importance in the current worldwide economic expansion raises the prospect of a virtuous cycle, with rising productivity in the United States, Japan and elsewhere creating both new supplies and demands for traded goods. GATT economists are quick to join their IMF counterparts in adding that such a favorable scenario by no means is guaranteed. Macroeconomic imbalances and periodic sectoral overinvestment are just two examples of problems that will remain, GATT warns. Even so, GATT hints that the late 1980s and the early 1990s are coming to resemble the 1950s and the early 1960s -- which some free traders regard as just short of a golden age for international commerce, especially when compared to the troubled late 1960s and the 1970s. For Japan, a major beneficiary of the earlier climate and today among the world's leading traders, this prognosis is very good news indeed.

Douglas Ostrom

Japan Expands Aid To Eastern Europe

Recognizing the important political changes that have occurred in certain Eastern European countries during the past year, Japan pledged October 21 to provide greater economic assistance to Poland and Hungary, two countries considered by Tokyo to be the most "reformist" in the region. These initiatives are in line with Prime Minister Toshiki Kaifu's plan to become more

active diplomatically after his Diet election October 31 to a full, two-year term as prime minister, according to Foreign Minister Taro Nakayama. However, Japan's increased responsiveness to the economic needs of the Soviet bloc countries may represent yet another aspect of Tokyo's ongoing effort to assume greater responsibility for the world's trade and development problems.

In anticipation of a late November meeting in Brussels of the major Western industrial nations on the economic crisis in Eastern Europe, Tokyo reportedly has adopted a set of measures aimed at supporting the economic reforms launched in Poland and Hungary. According to Japanese government sources, the new policy calls for active participation in a $643 million assistance plan proposed by the European Community, under which the EC has pledged to provide approximately $321 million and the United States about $126 million. Tokyo has not yet said how much money it would contribute to this effort. The Foreign Ministry in early October formed a special working group to develop economic assistance proposals with special attention to Poland's food shortage. Given the seriousness of this problem, Mr. Nakayama indicated that Tokyo may offer Warsaw emergency food aid before a more comprehensive aid package is proposed.

Mr. Kaifu told the House of Councillors Budget Committee October 24 that he is studying the possibility of visiting Eastern Europe in early January as one leg of an overseas trip that also would take him to various Western European countries. Mr. Nakayama the day before was reported to have strongly encouraged the prime minister to visit Hungary and Poland, in particular, as soon as possible. This type of high-level diplomatic contact would "clearly elucidate [Japan's] position toward reformist countries in the region," the foreign minister reportedly stated.

In negotiations in Warsaw October 25 Tokyo agreed to reschedule Y56.3 billion ($402.1 million at Y140=$1.00) worth of official debt incurred by Poland. About Y48 billion ($342.9 million) of this total reflects export insurance paid out by the Japanese government to cover Poland's past failure to pay for imports from Japan. Another Y8.5 billion ($60.7 million) represents loans extended by the Export-Import Bank of Japan. The agreement calls for Warsaw to repay the principal and interest over five years after a five-year grace period. Japan apparently was the last of Poland's creditor nations to reach an agreement on debt rescheduling. Jan Majewski, Polish deputy foreign minister, is expected to review this and other aspects of Japan's assistance to his country on his November 4-9 Tokyo visit.

The Japanese government also reportedly is considering ways to extend help outside the rubric of its official development assistance program. The Ministry of Foreign Affairs, which is the lead agency for Japan's foreign aid programs, has responded that while there is increasing awareness of the magnitude of the needs in Poland and Hungary, Tokyo has not yet decided whether or to what extent it should exceed the parameters of the ODA program. However, the government has indicated it intends to increase activities generally designed to promote friendly ties with Warsaw Pact countries, such as sending environmental missions there and holding seminars to promote economic relations with them.

Poland and Hungary are not the only Eastern European countries clamoring for Japanese aid. During his October 26 meeting with Mr. Kaifu, Bulgarian deputy prime minister Petko Danchev was not in the least bit reserved in encouraging greater Japanese investment in his country. Mr. Danchev told the prime

minister that Bulgaria is implementing various economic reforms, some of which are designed to boost the country's attractiveness to Japanese investors. The Bulgarian official also urged Mr. Kaifu to add Sofia to his January travel agenda.

As the Table indicates, Japan's economic relations with Eastern Europe have not been extensive. Thus, it is hard to credibly argue, as some analysts have, that Tokyo's recent pledge of generosity is motivated by a desire to protect sizable assets. While Japanese businessmen no doubt are eyeing Eastern European markets for possible expansion -- as they would evaluate any new market

Japan's Trade with Eastern Europe, 1980-88

(in millions of dollars)

	1980	1985	1986	1987	1988
Eastern Europe					
Exports	$807,217	$563,759	$682,026	$716,673	$775,831
Imports	255,760	316,214	344,519	475,903	691,611
Trade Balance	551,457	247,545	337,507	240,770	84,220
Bulgaria					
Exports	65,316	123,421	160,513	117,222	160,590
Imports	22,071	22,118	18,087	24,851	49,546
Trade Balance	43,245	101,303	142,426	92,371	111,044
Czechoslovakia					
Exports	63,466	56,935	61,759	63,086	48,243
Imports	49,379	53,110	56,886	80,817	116,819
Trade Balance	14,087	3,825	4,873	-17,731	-68,576
East Germany					
Exports	138,666	137,133	119,293	201,138	154,734
Imports	39,689	43,967	51,883	59,231	92,602
Trade Balance	98,977	93,166	67,410	141,907	62,132
Hungary					
Exports	107,320	83,247	82,271	91,733	101,338
Imports	17,447	52,306	61,265	97,928	163,816
Trade Balance	89,873	30,941	21,006	-6,195	-62,478
Poland					
Exports	228,176	73,214	146,087	166,862	258,037
Imports	61,571	67,443	55,779	75,587	115,989
Trade Balance	166,605	5,771	90,308	91,275	142,048
Romania					
Exports	202,655	89,566	111,476	76,436	52,597
Imports	65,577	65,045	95,415	132,756	142,175
Trade Balance	137,078	24,521	16,061	-56,320	-89,578

Source: Japan Tariff Association

opportunities -- the Japanese government's position appears to be influenced more by a desire to demonstrate that it recognizes Japan's obligation to assume greater responsibility for global economic problems. The Soviet Union's glasnost policy also may have made it easier for Tokyo to contemplate a new policy toward this region since it appears that some Warsaw Bloc countries no longer want to follow Moscow lockstep.

Barbara Wanner

Congressional Measures Target Foreign-Owned Companies

Foreign governments, including Japan, have been lobbying against a low-profile provision in both the House-passed deficit-reduction bill and its Senate counterpart that increases tax reporting requirements for American companies controlled by foreign owners. Capitals around the world believe the measure could discourage foreign investment in the United States. For the same reason foreign governments also are concerned about three other tax-related provisions in the House bill (but not the Senate version) that would affect foreign investors.

The deficit-reduction package, formally known as the Omnibus Budget Reconciliation Act of 1989, currently is in the hands of a conference committee where members are trying to combine the House-passed bill, HR 3299, and the Senate Finance Committee version, but the participation of 231 conferees is expected to slow progress indefinitely. A capital gains tax cut and the repeal of catastrophic health insurance are among the major measures attached to the legislation, and they are taking center stage during the conference committee debate.

Both the House and the Senate provisions regarding Internal Revenue Service reporting requirements for domestic companies owned by foreigners are designed to increase compliance with U.S. tax laws, their sponsors say, but the two measures differ on specifics. For example, while Section 6403 of the Senate Finance bill requires that appropriate records be kept, Section 11403 of the House version specifies that the records be maintained in the United States. Moreover, the number of foreign businesses potentially affected varies because each chamber has its own definition of foreign ownership. The Senate Finance provision says a company is foreign-owned when 25 percent of its stock or value is held by one nondomestic party, whereas HR 3299 defines a foreign-owned business as a company that is 25 percent owned by a group of foreign shareholders, of which at least one has a stake of 10 percent or more.

Regardless of the definition of foreign ownership, foreign governments believe that the proposed reporting requirements would undermine the tax treaties the United States has with countries such as Japan, Canada and the United Kingdom since these treaties contain effective procedures for exchanging information to determine U.S. tax liability. It also is argued that the provisions in the House and the Senate bills would place a heavier reporting burden on foreign-affiliated firms than on domestic companies, especially if records had to be maintained in English and in dollar terms. Therefore, foreign governments add, the measures violate bilateral tax treaties, which forbid discrimination against foreign-owned businesses with respect not only to taxation but also to related reporting requirements and other rules.

Notes

Opposition Tax Bills - Opposition parties, which organized as a coalition in the current special Diet session, submitted to the upper house October 26 a two-year package of tax increases to finance the revenue loss from the proposed repeal of the 3 percent consumption tax. They had introduced their plan to abolish the consumption tax at the September 28 opening of the current session (see JEI Report No. 38B, October 6, 1989).

The major components of the package are: the reintroduction of commodity taxes to raise Y1,269 billion ($9.1 billion at Y140=$1.00); the cancellation of a planned cut in corporate tax rates for Y1,380 billion ($9.9 billion); an increase in the withholding tax applicable to stock sales for Y625 billion ($4.5 billion); a hike in the top rates of the inheritance tax and the gift tax for Y7 billion ($50 million); the revival of certain local indirect taxes for Y1,250 billion ($8.9 billion); and a growth-linked revenue increase of Y1,409 billion ($10.1 billion). The Japan Socialist Party and the Democratic Socialist Party resolved a major political rift over the proposed commodity tax rate for cars and trucks by agreeing to set it at 8 percent of the factory price, which tax analysts calculate is equivalent to the current 3 percent consumption tax on the retail price. The projected total of Y5,940 billion ($42.4 billion) that would be raised by these measures in FY 1990 is said to be enough to recover the revenue lost from the repeal of the consumption tax.

The opposition's tax package is expected to be debated for three to four weeks before reaching a floor vote, according to Hiroshi Mitsuzuka, chairman of the Liberal Democratic Party's policy committee. He suggested that the LDP will join the discussion rather than throw up a roadblock to stop the debate. If so, the bills could pass the opposition-controlled upper house in late November and run head-on into the LDP tax reform plan being reviewed in the lower house, where the LDP has a majority. What might happen then is uncertain, but the outcome is expected to influence whether lower house elections will be held, as currently rumored, in late February 1990.

Manufactured Imports - Four years ago Japan's imports of manufactured products added up to $36.4 billion. In 1989 purchases of foreign machinery, transportation equipment, precision instruments, chemicals and other finished industrial inputs and consumer goods are expected to top $100 billion, thanks to the strong yen, robust domestic demand and the spreading awareness among big Japanese companies of the benefits -- both political and economic -- of buying foreign (see Table). Yet this spectacular growth is unlikely to end complaints from American trade policymakers, manufacturers and economists that Japan's imports of manufactured products are too low -- whether measured as a share of total overseas purchases (about 47 percent versus nearly 80 percent for the United States and 60 to 70 percent for European countries) or on a per capita basis (less than half the comparable number for other leading industrial nations.)

Over the last year or so overseas critics of Japan's track record on manufactured imports have gained an unexpected ally in Tokyo: the Ministry of International Trade and Industry. MITI's initial import promotion efforts were limited mainly to jawboning 300-plus big Japanese importers and manufacturers to expand their purchases of finished products from abroad by 30 percent a

year. But with the slower growth of manufactured imports this year signaling that the easy gains already have been made and analysts projecting an increase in Japan's trade surplus in 1990, MITI has unveiled a plan to provide direct support for larger purchases of manufactured goods from foreign suppliers.

Japan's Imports of Manufactured Products*

(in millions of dollars, c.i.f. value)

	1980	1985	1986	1987	1988	Eight Months 1989
Chemicals	$6,202	$8,072	$9,733	$11,845	$14,830	$11,008
Manufactured Goods Classified by Material	10,579	10,886	12,390	18,055	27,340	20,229
Machinery and Transport Equipment	8,756	11,106	13,283	17,264	24,727	19,194
Miscellaneous Manufactures	5,031	6,349	8,634	13,396	18,702	15,058
Manufactured Imports	30,568	36,413	44,040	60,560	85,599	65,489
Total Imports	140,528	129,539	126,408	149,515	187,354	138,314
Manufactures/Total Imports	21.8%	28.1%	34.8%	40.5%	45.7%	47.3%

*SITC 5-8.

Source: Japan Tariff Association

The centerpiece of the new initiative, proposed to go into effect next April, is a tax write-off for companies that boost imports of manufactures on a year-to-year basis. Although the size of the credit still is being discussed, the figures MITI has floated to the press indicate that it has a fairly modest tax break in mind -- something on the order of Y30 billion ($214.3 million at Y140=$1.00) in FY 1990 compared with projected corporate tax payments of Y18.4 trillion ($131.2 billion) in the current fiscal year. Still, ministry policy planners are hopeful that the plan provides enough of an incentive to get the huge number of small and midsized companies, which have been slow to increase manufactured imports, to expand offshore sourcing.

The response of foreign manufacturers to MITI's proposal has been muted, but it is not hard to second-guess the probable majority reaction: irked that Japanese companies might need tax incentives to break their buy-national purchasing practices but thankful for any help they can get in expanding sales. In Japan most manufacturers and importers had little to say about the plan, although spokesmen for industries that no longer are internationally competitive criticized the latest idea for boosting imports. Ministry of Finance officials were not so reticent, arguing that Japan already had done enough to expand imports and that big companies were more likely to benefit from the proposed tax break than MITI's primary target, small and midsized firms. That reaction has led analysts to conclude that if any money is included in the FY 1990 budget for the MITI plan, it will be even less than the modest amount currently being discussed.